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**Incentives, inequality and taxation: The Meade Committee Report on the  
Structure and Reform of Direct Taxation. (1978)**

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**Incentives, inequality and taxation: The Meade Committee Report on the  
Structure and Reform of Direct Taxation. (1978)**

**Abstract:**

The publication in 1978 of a report on *The Structure and Reform of Direct Taxation* by a committee headed by the economist James Meade marked the first fundamental study of the UK tax system commissioned by the Institute for Fiscal Studies. Many of its main recommendations centred around a shift away from taxing income and towards taxing expenditure. Tax incentives to save and reductions in marginal rates of income tax were designed to improve incentives to earn and to invest income. Such a shift characterised the UK tax system from 1979, albeit without acknowledging the work of the Meade Committee.

## **Incentives, inequality and taxation: The Meade Committee Report on the Structure and Reform of Direct Taxation. (1978)<sup>1</sup>**

(7,892 words)

“Our Report is a joint effort, but I take this opportunity of expressing a personal view. Our economy has become too stagnant; restoration of standards of living and many desirable increases in economic welfare depend upon high productivity. At the same time a modern humane society demands that effective action should be taken to prevent poverty and to remove unacceptable inequalities of opportunity, wealth and privilege”. (James Meade, Preface to the Report on *The Structure and Reform of Direct Taxation*, 1978, p. xv)

**KEYWORDS:** Taxation; incentives; utilitarianism; wealth; inequality.

### **Introduction**

A persistent concern in Les Hannah’s work has been with the interaction of market mechanisms, economic theory and institutions. The early work on industrial concentration picked up Coase’s question as to when and why firms internalise market operations while also emphasising that the drift to a high level of industrial concentration in UK manufacturing by 1971 coincided with its comparatively poor international economic growth performance<sup>2</sup>. The two-volume history of the UK electricity supply industry necessarily involved discussion of the interaction of time and economics, whether in the attempts to price peak-hour electricity efficiently or in the use of discount rates in the appraisal of proposed fixed capital investment projects<sup>3</sup>. It also pointed to the paradox whereby the government initiated the construction of a natural monopoly grid so as to stimulate competition in the generating section of the industry. Time, taxation and the growth of large companies underpinned Les’s study of the development of occupational pension schemes in the UK<sup>4</sup>.

This interest in how decisions were made, of how they were shaped by the interaction of markets, institutions and individuals was evident from the very earliest days of the Business History Unit. Located on the fourth floor of the Lionel Robbins

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<sup>1</sup> I would like to thank Martin Daunton, James Foreman-Peck, Les Hannah, John Kay, Lord Mervyn King, Peter Scott, Douglas Todd and participants at the conference in Reading in March 2017 for their comments on an earlier version of this paper. All responsibility for errors of fact and understanding remain mine.

<sup>2</sup> Hannah and Kay, *Concentration in Modern Industry*; Hannah, *Rise of the Corporate Economy*; Coase, ‘Nature of the Firm’.

<sup>3</sup> Hannah, *Electricity Before Nationalisation*

<sup>4</sup> Hannah, *Inventing Retirement*

Building at the LSE, the unit was established in 1978 with Les as its first Director. In his later inaugural lecture on 11<sup>th</sup> October 1983 as holder of the first established chair in Business History at the LSE, Les emphasised both the need to pay closer attention to entrepreneurs and entrepreneurial decisions, but also to find a theoretical and empirical mixed approach for ‘the analysis of change (which) is at the heart of the entrepreneurial function’.<sup>5</sup> While Les emphasised the variety of incentives and motivations for entrepreneurial behaviour, he also acknowledged that ‘in tax policy making...it seems to be quite widely accepted that reducing the taxation of income will increase entrepreneurial efforts’.<sup>6</sup> Incentives and wealth creation were strong themes in the 1979 general election, as too was taxation. In discussing how to improve incentives for work and wealth creation, the tax system was a favourite target for criticisms. That tax system had itself been buffeted and distorted by the inflation of the 1970s, and it was both to remove its inconsistencies and to improve incentives for effort that the Institute for Fiscal Studies (established in 1969) invited the economist James Meade to chair a committee to undertake a review of the tax system. That committee published its Report in 1978.

The reception of that report forms the focus of this article for two main reasons. Firstly, in the period since 1979 there has been growing concern with inequality, and in particular with inequality of wealth. Was there any evidence at the time of the Meade Committee of how a concern with incentives might coincide with moves to halt and begin to reverse the post-war trend to redistribute wealth in the UK? In short, why might a government, elected to improve incentives and opportunities, receive a history which pays at least as much attention to its contribution to increasing wealth inequality in the UK from 1979. Secondly, given that the Meade Committee’s report was concerned with the intergenerational transfer and distribution of wealth, how and why were its proposals for taxing the transfer of unearned wealth blocked? How and why does this contrast with the reception of other sections of the report, whether on marginal rates of income tax, the balance between direct and indirect taxation, and the offering of tax-relief on life-cycle savings. Since the question of how institutions, systems, individuals and economics interact is a persistent concern of Les’s work, it seems appropriate to ask how a major report tackling just such issues as were embedded in the tax system was received and used following its publication in 1978.

### **The Meade Committee**

The Meade Committee was established in 1975, its chairman James Meade beginning work in July and the committee meeting for the first time in October of that year. James Meade was Emeritus Professor of Political Economy at the University of Cambridge. In 1977 he and Bertil Ohlin, were to be awarded the Nobel Laureate in Economics for their work on international trade and international capital movements. The committee of which Meade was chair included some of the brightest academic economists of a younger generation including John Kay, Mervyn King and Tony Atkinson, initially in 1975 as research secretaries but from 1976 as full members of the committee. Tony Atkinson subsequently resigned from the committee, ostensibly because of being appointed to the Chair of Political Economy at University College London.

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<sup>5</sup> Hannah, *Entrepreneurs*

<sup>6</sup> Hannah, *Entrepreneurs*, p. 17.

Appropriately in 1975, when the annual rate of inflation was running at 25%, part of the committee's remit was to review the system of direct taxation, just one of whose difficulties was its struggle to accommodate the effects of the inflation of the 1970s. As Meade explained in a letter to Geoffrey Howe, the Shadow Chancellor of the Exchequer, the intention of the Committee's proposed tax reforms were to "provide the most favourable tax background for the development of private business enterprises and in particular for small business"; to stop the capital market being the "hideous mess which it is at the moment due to the interplay of the present income tax, corporation tax and capital gains tax"; to provide a check in the shift from income to expenditure taxation on a government's ability to use inflation to increase its revenue; and to end at both ends of the income scale marginal tax rates at their "present absurd levels".<sup>7</sup> The committee had been established and the Report 'originally commissioned by the Institute for Fiscal Studies after ministers rejected calls by the Sandilands Committee and others for a Royal Commission on the whole of the taxation system, on the grounds that it was too large an undertaking'.<sup>8</sup> Throughout its two-year life, in which remarkably it produced a report of 519 pages (including 37 appendices) the Meade committee was tracked by the Conservative Party Taxation Committee (CPTC), chaired by David Howell.<sup>9</sup> The Treasury and the Inland Revenue also kept a keen eye on the committee's activities, and equally the IFS ensured that the Treasury and Inland Revenue were kept informed of its progress.<sup>10</sup>

The Meade Committee, the CPTC and the Treasury were all agreed that the highest marginal rate of taxation of 98% (an 83% marginal rate of income tax added to an investment income surcharge of 15%) was too high. For the CPTC the tax rate of 83% alone caused difficulties in recruiting senior industrial management when "at 83%, our top rate on earned income leaves a take-home on marginal earnings of only about a third that of an American executive (top rate 50 per cent) or a German executive (top rate 53 per cent)".<sup>11</sup> The Treasury was well aware of industry and CBI claims about the disincentive and recruitment effects of high marginal tax rates, but it found such claims difficult to demonstrate.<sup>12</sup> While the marginal rate of taxation affected incentives, the average tax rate was the greater influence on the redistributive content of the tax system. Unsure of the extent to which very high marginal rates affected work incentives, the Treasury, like the Meade committee, did think that there was "a good case for aiming to reduce the 'top' rate to at least 75% and possibly to 70% (or even 65%)". However, in February 1979 its view was that "the case for going further than this does not seem strong".<sup>13</sup>

By the mid 1970s the basis of taxation was once again a matter of heightened economic and philosophical interest. The proceedings of one such conference meeting of economists and philosophers in May 1975 were gathered together in a volume entitled *Utilitarianism and Beyond* edited by the economist Amartya Sen and

<sup>7</sup> Meade Papers (hereafter Meade) 6/2 (1977a)

<sup>8</sup> The National Archives (hereafter TNA) T364/149 (1977b), paras. 23, 24, 29, 32.

<sup>9</sup> The Thatcher papers (hereafter THCR) 2/6/1/36 (1977)  
THCR 2/6/1/27

<sup>10</sup> TNA T366/4, para 2.  
TNA T366/205 (1976a)

<sup>11</sup> THCR 2/6/1/35

<sup>12</sup> TNA T366/383

<sup>13</sup> TNA T171/1450, paras. 5, 6, 7a, 9.

the philosopher Bernard Williams.<sup>14</sup> Coming to the fore at this time was the work of one conference speaker, James Mirrlees, whose work was well known to Meade, if not entirely agreed with. Aware that many arguments for low marginal tax rates for the rich were ‘premised on the odd assumption that any means of raising the national income is good, even if it diverts part of that income from poor to rich’, Mirrlees was surprised that his ‘rigorous analysis of income taxation in the utilitarian manner’ did not provide an argument for high tax rates’. In general, Mirrlees’ conclusion was that ‘income tax is a much less effective tool for reducing inequalities than has often been thought’.<sup>15</sup> More widely, academic work by Mirrlees, Feldstein, Atkinson, Fair and Rawls was incorporated by Rachel Lomax at the Treasury in a paper surveying academic research on tax structures and theories of redistribution.<sup>16</sup> Such Treasury research fed into its five-year Medium Term Tax Strategy whose shape was becoming clear by 1978. Priority was given to ‘improving incentives’ by some strengthening of the higher rate bands, introducing a longer reduced rate band of significant length, having a modest reduction in the basic rate to 32%, and reducing the top rate of taxation from 83 per cent to 75 per cent. Income tax reductions would be financed by an increase in VAT over the medium term.<sup>17</sup>

This shift from direct towards indirect taxation was in line with the thinking and proposals of the Meade Committee. The idea of an expenditure tax went back in the post-World War II period most obviously to Nicholas Kaldor’s book, *An Expenditure Tax* (1955). Indeed, when Meade sent Kaldor a draft copy of the committee’s report, Kaldor wrote thanking him and admitting that while he had not yet had time to “study it in any detail I found it very gratifying that you advocate an Expenditure Tax on much the same lines as I did when I wrote my book 23 years ago!”<sup>18</sup> Before Kaldor, the intellectual roots of an expenditure tax stretched through Marshall, Pigou and Mill and back to Hobbes.

By an expenditure tax is not meant an indirect (VAT) tax on current expenditure, but rather a tax on an individual’s total consumption across a year, this being measured by calculating the difference between the individual’s receipts and payments during that year. Receipts would comprise both personal income, such as wages, dividends and rent, as well as capital receipts, such as from the sale of capital assets where the sale proceeds was not then fully used to purchase assets of an equivalent value. Gifts and other windfall income were included in total receipts from which non-consumption expenditure (as on assets, repayments of past borrowings, or simply an increase in the individual’s money balance) could then be deducted. The balance left once deductions for receipts were made was held to represent expenditure on consumption and was taxed.

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<sup>14</sup> Mirrlees, “Economic Uses”

<sup>15</sup> Mirrlees, “An Exploration” p. 208.

Diamond and Mirrlees, “Optimal Taxation I”

Diamond and Mirrlees, “Optimal Taxation II”

Atkinson, “How Progressive”.

<sup>16</sup> Atkinson, “Bringing income distribution”,

Fair, “Optimal Distribution”

Feldstein, “Distributional Equity”.

Feldstein, “Optimal Progressivity”

Mirrlees, “An Exploration”

Rawls, “Some Reasons”

TNA (1975).

<sup>17</sup> TNA T378/88, paras. 6, 12, 14, 16, 19.

<sup>18</sup> Meade 6/11

While the intellectual provenance of an expenditure tax, its main attraction had been its ability to avoid the ‘double taxation;’ of savings occasioned by income taxation. Keynes’s view of an expenditure tax was that while it was ‘perhaps theoretically sound, it is practically impossible’<sup>19</sup>, although work by the economist Irving Fisher on the similarity between calculating the net savings and dis-savings (spending out of cap[ital] of individuals and businesses was slowly realised to have made expenditure taxation practicable. In the United States, in September 1942, the Treasury presented to Congress a proposal for a progressive spending tax as their principal suggestion for war finance, although the Finance Committee of the American Senate greeted the proposal with considerable hostility. In the UK, the economist Nicholas Kaldor wrote his book *An Expenditure Tax* (1955) as an offshoot of his work as a member of the Royal Commission on the Taxation of Profits and Incomes which was appointed in 1950.<sup>20</sup>

An expenditure tax necessarily involved lifetime taxation of the use of wealth, either on the basis of a universal expenditure tax based on a list of registered assets and/or using a Two-Tier Expenditure Tax which placed a surcharge on levels of expenditure above a basic rate band. Ideas for the taxation of wealth included the ingenious PAWAT (Progressive Annual Wealth Accessions Tax) scheme which taxed donees rather than donors and taxed on a progressive basis the possession of wealth as if the donee was to live to be 85 years of age.<sup>21</sup> Such proposals were made in a context in which other Labour Party and Labour government schemes for taxing wealth had run into the sand.

### The administrative response

Opposition to the committee’s proposals for an expenditure tax and a new approach to the taxation of wealth came from varied sources. Perhaps the most curious response to the Committee’s proposal for an expenditure tax was that of the Inland Revenue. As with the Treasury, the IFS had sought to keep the Inland Revenue informed of the Committee’s progress in meetings chaired by Sir William Pile, Board Chairman of the Inland Revenue.<sup>22</sup> In response to the Meade Report the Inland Revenue wrote a 79-page analysis of an expenditure tax, a copy of which J H Gracey of the Inland Revenue sent to Meade in January 1980, as it and other papers relating to the Revenue’s examination of an expenditure tax were made available to the public.<sup>23</sup> The Revenue emphasised what it saw as the practical difficulties of implementing an expenditure tax and argued that the Meade committee had failed to appreciate the extent to which the tax system was a political construct and not simply an economic structure with efficiency as its main concern.<sup>24</sup>

<sup>19</sup> Kaldor, *An Expenditure Tax*, p. 12.

<sup>20</sup> Kaldor, *An Expenditure Tax*, p. 7.

<sup>21</sup> IFS, *Structure and Reform*, pp. 317-318.

<sup>22</sup> TNA T364/149 (1977a) para. 1.

<sup>23</sup> Meade 10/17 (1980)

<sup>24</sup> Meade 10/17 (1978), paras. 7, A3, D3-4.

Kaldor, *Expenditure Tax*

Vickrey, “Expenditure”.

Musgrave, *Theory of Public Finance*

Shoup, *Public Finance*.

Prest, “A tax?”

Prest, “The Expenditure Tax”.



“The tax system is not a seamless and logically consistent web. It is, we think, inherent in the nature of the political debate that this should be so; and the idea of a universally acceptable tax structure, which no longer needed to respond to the political and economic requirements of the day, strikes us as a chimerical one”.<sup>25</sup>

The Inland Revenue argued that inconsistencies existed within the existing system, precisely because they reflected “deliberate policy decisions in response to the different and often conflicting political and economic pressures of the last generation or so”. Yet, it was precisely a tax system which provided incentives for effort, rather than enshrining past political deals, which the Meade committee sought to establish. This interest in creating a dynamic system was captured in a letter which John Kay wrote to J H Gracey of the Inland Revenue, shortly after the publication of the Meade Report:

“I enjoyed your description of the kind of tax system which the report advocates as being one of fiscal snakes and ladders. It is certainly true that a number of commentators on the report have seen an element of paradox in it. Personally, I see no paradox at all. It seems to me that this is exactly what the tax system of a country that really cares both about fairness and about incentives would be like. Snakes and ladders implies that we reward effort, and if the effort is not sustained we take the rewards away again. The paradox is mainly seen by those who look at issues through the somewhat distorting spectacles of party politics”.<sup>26</sup>

Having written their 79-page analysis of the Meade Committee’s proposals for an expenditure tax, the Inland Revenue were contemptuously dismissive of the entire report. Branding the Meade Report’s approach to the reform of the tax system as ‘somewhat misconceived’ the Revenue reiterated their view that: “The Report is disappointing: its original proposals are not practicable, and its practicable proposals are not original”.<sup>27</sup>

This Inland Revenue’s view was not shared by the Treasury<sup>28</sup> which was critical of the condemnation of “the Report as entirely irrelevant and useless – as the Revenue appears to do”. Instead, observing that it was always “easy to do a hatchet job on a theoretical analysis of this kind”, Treasury officials acknowledged that there was wide recognition that the tax system was “urgently in need of reform”. They also questioned why, if the Report was “as way out and as irrelevant as the Revenue seems to imply”, the Revenue had not sought to “to influence the course and approach of the exercise at an early stage” since the Meade Committee had done “their best to keep us fully informed of the lines on which they were working, and officials participated in their decisions from time to time”.<sup>29</sup>

Where the Treasury was concerned about the report was in the impact on the proposed expenditure tax on incentives. In a meeting with the IFS, the Treasury’s

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Prest, *Public Finance*

<sup>25</sup> TNA T364/149 (1977b), para. 21.

<sup>26</sup> Meade 6/1

<sup>27</sup> TNA T364/149 (1977b), paras. 23, 24, 29, 32.

<sup>28</sup> TNA T364/149 (1978c)

<sup>29</sup> TNA T364/149 (1977a), para. 5.

Barry Kalen complained that the potential substitution effects of a two-tier expenditure tax (TTET) and the impact on incentives of an expenditure tax in the absence of a tax-free threshold had received insufficient attention.<sup>30</sup> The two-tier expenditure tax would in effect be two separate taxes, one for the lower tier and the other for the upper tier of a taxpayer's expenditure. Citing A R Prest's September 1959 *Economic Journal* article, Kalen complained that 'the issue of incentives to work is completely ignored'. Similarly Todd noted that "no arguments are developed properly on possible disincentive effects, e.g. the willingness to work or take risks" which he regarded as "a great weakness in the Report since the opening chapter places such a great emphasis on efficiency and yet at the end of the day the arguments virtually disappear and other criteria concerned more with equity become more apparent".<sup>31</sup> Yet, as his Treasury colleague, John Odling-Smee argued to Todd, such criticism missed the point that Meade's was "a concern for efficiency and the minimisation of distortions" throughout the whole system, rather than with a particular substitution effect. As this approach revealed 'weaknesses and anomalies' then these could be addressed, not least in Meade's view by moving onto an expenditure base.<sup>32</sup> However, in general, the Treasury recognised the 'substantial economic and social benefits' from adopting Meade's principles of taxation, albeit in "in a piecemeal and evolved fashion" and with the proviso that "the concept of a slow progress of evolution towards a better system need not include complete adoption of an expenditure tax objective".<sup>33</sup>

### The political response

Whatever the contrasting administrative responses from the Inland Revenue and the Treasury, ominously the most outright opposition came from Conservative politicians. When Meade presented an exposition of the Report's main principles and recommendations to a group of Conservative MPs on 22<sup>nd</sup> November 1977 prior to its official publication, he drew a belligerent response from his audience.<sup>34</sup> Following the meeting Meade wrote to its organiser, Sir Geoffrey Howe, expressing his "surprise at the unmitigated hostility shown by the majority of your group".<sup>35</sup> Howe's main defence was that "unmitigated hostility" was "not the real spirit of our reaction" but rather a "political abhorrence, born of many Finance Bill Standing Committees, of anything which involved complex replacement of familiar fiscal machinery when simplification and adaptation, of course, on a basis of principle, would do as well".<sup>36</sup> By way of an olive branch Howe commended to Meade chapter 3 of the Conservative Party's recently published pamphlet *The Right Approach to the Economy*, as well as Howe's own recent talk to the Addington Society which was reprinted in that year's *British Tax Review*.<sup>37</sup>

Whatever Howe's emollient words, there was no disguising the Conservative Party's determined opposition to suggestions of further taxation of capital. This had been a consistent theme from at least the mid 1970s, when the CPTC had

<sup>30</sup> TNA T366/205 (1977b) para 6.

<sup>31</sup> TNA T364/149 (1978c) para 11.

<sup>32</sup> TNA T364/149 (1978d)

<sup>33</sup> TNA T364/149 (1977a) para. 7

<sup>34</sup> Meade 6/2 (1977c)

<sup>35</sup> Meade 6/2 (1977a)

<sup>36</sup> Meade 6/2 (1977b)

<sup>37</sup> Howe, "Reform".

Howe, Joseph, Prior and Howell, *Right Approach*

expressed its forthright determination to end the ‘political’ taxation of the rich, particularly through capital transfer tax”.<sup>3839</sup> A good part of the future Thatcher Conservative governments’ taxation policy was to be found in the Meade Committee’s Report. The Thatcher governments introduced reforms designed to encourage saving and equalise the post-tax returns on investment. Maximum tax rates of investment income were reduced from 98% to 40% and the equalisation of the marginal taxation of income and capital gain removed the incentive to convert income into capital gain. In 1984, income tax relief on premiums payable for life assurance was abolished and the tax-free schemes for saving in cash or equities were established in 1987. In 1988 personal pensions were introduced which enjoyed the same tax relief on contributions, fund income and withdrawals as employer-based occupational pensions. As the Meade Report had envisaged, most life-cycle savings came to qualify for expenditure tax treatment.<sup>40</sup> Taxation featured strongly in the 1979 general election, although the Meade Report was barely mentioned in the campaign.<sup>41</sup> Under pressure from Geoffrey Howe, Mrs Thatcher did agree to make a shift from direct to indirect taxation. The basic rate of income tax was reduced from 33% to 30% in the government’s first Budget in June 1979 and again to 29% in 1986, 27% in 1987, and 25% in 1988. Cuts were also made to higher tax rates, from 83% to 60% in June 1979 and from 60% to 40% in 1988.<sup>42</sup> Tellingly, when pressure on the PSBR in 1993 required tax increases in two Budgets in that year, the two Chancellors introduced a package of tax increases which, while in terms of revenue raised, reversed most of the tax reductions of the late 1980s, they did not fall on income but on VAT for which the standard rate was raised from 15% to 17.5% and extended to include domestic fuel.<sup>43</sup>

What was more contentious and not in the spirit of the Meade Report was the reduction of the top rate of income tax from 60% to 40% in March 1988. As the political philosopher Gerry Cohen noted, this could be held to offend against the principle of ‘justificatory community’, a concocted notion which required the relevant agents to justify their behaviour to the community.<sup>44</sup> By 1988 the Conservative government had moved a long way from the concern of the Conservative Taxation Committee in 1975 about “awarding a ‘payrise’ to many executives just to make them work harder”.<sup>45</sup> The change in the highest marginal income tax rate was greater than that which the Meade Committee (70%) and the Treasury (65% at most) in 1979 had thought likely to have any necessary effect on work/leisure incentives.<sup>46</sup> It also raised questions as to the extent to which any individual could be truly said to ‘deserve’ their income. Aside from luck, if talent caused an individual to prosper, the political philosophical question arose of the extent to which an individual ‘owned’ the beneficial proceeds of his/her talents. On such an issue there was common

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<sup>38</sup> THCR 2/6/1/36

<sup>39</sup> THCR 2/6/1/35

<sup>40</sup> Adams, Browne and Heady, “Taxation”.

Banks and Diamond, “The Base”.

<sup>41</sup> Kay, “Meade Report”, p. 47.

<sup>42</sup> In moving in 1988 to the 40% and 25% income tax rates, the Treasury had been influenced by a paper written by Mervyn King for the Financial Markets Group at the LSE in late 1987. Personal communication from Lord King.

King, “Prospects”.

<sup>43</sup> Giles and Johnson, “Tax Reform”.

<sup>44</sup> Cohen, “Incentives”.

<sup>45</sup> THCR 2/6/1/35

<sup>46</sup> Brown and Sandford, *Taxes and Incentives*..

ground between Meade, Hayek and Rawls. Hayek thought that “the inborn as well as the acquired gifts of a person clearly have a value to his fellows which does not depend on any credit due to him for possessing them”.<sup>47</sup> For Rawls, his Difference Principle represented, in effect, an agreement to regard the distribution of natural talents as a common asset.<sup>48</sup> If the principle was the redress of undeserved inequalities, then it was consistent to argue for a redistribution of resources to mitigate the intergenerational transfer of relative advantage. Although Hayek objected to Rawls’s use of the term ‘social justice’, he welcomed his argument that rather than a particular system or distribution being designated as ‘just’, it was the principles of justice which defined “the crucial constraints which institutions and joint activities must satisfy if persons engaging in them are to have no complaints against them”.<sup>49</sup>

### Wealth and public fixed investment

If the Meade Report proposals for the encouragement of saving, the equalisation of the post-tax rates on investment, and a shift between direct and indirect taxation, were all reflected in the Conservative governments’ taxation policies, the committee’s proposal for the taxation of wealth were conspicuous by their absence from policy-making. Inheritance tax continued to be levied on donors rather than donees, its contribution to public finance revenue dwindling down to 0.5% of forecast UK tax revenue in 2011-12.<sup>50</sup> Principal residences continued to be exempted from Capital Gains Tax on their sale while second and additional homes had their capital gains rolled up into inheritance tax at the death of their owner. Owner-occupiers continued to live free of taxation in the imputed rental income from their property following the abolition of Schedule A taxation in 1963. Changes in the distribution of wealth and income particularly favoured the highest reaches of the income and wealth scales. Across the 1990s, the top 1% of wealth holders increased their share of marketable wealth from 17% in 1991 to 23% by 2001. The top 0.05% of income earners went back to enjoying their pre-World War II share of income after tax, this being 2.41% in 1997 compared with 2.37% in 1937.<sup>51</sup>

Perhaps as importantly, the Conservative governments sold off some of the public stock of assets such that the public sector asset net worth fell from 77.1% of GDP in 1980-1 to 62.86% in 1990-1. However, it fell even further in the post-Thatcher 1990s from the 62.8% of 1990-1, to 21.6% in 1995-6 and to 15.6% in 1999-2000.<sup>52</sup> The eye-catching programmes of public asset sales were the sale of public housing and the ‘privatisation’ of nationalised industries. The sale of public housing represented an essentially irreversible transfer of capital assets. By selling a property at below market price (because it was without vacant possession), by definition the opportunity was lost of selling it in the future when it would have become vacant. One approach might have been to have included in the original sale price, provision for replacement with suitable adjustment for depreciation. As James Foreman-Peck pointed out in 1982: “To do otherwise is to dispose of public assets in a fashion arguably not in the best interests of the tax-payer who

<sup>47</sup> Hayek, *Constitution of Liberty*, p. 81.

<sup>48</sup> Rawls, *Theory of Justice*, pp 101-2.

<sup>49</sup> Hayek *Law*, p. 100.

<sup>50</sup> IFS, *Tax By Design*, p. 5.

<sup>51</sup> Hills, *Inequality*, p. 31

<sup>52</sup> Florio, *Great Divestiture*, Table 8.3, p. 279.

originally financed them; or alternatively to redistribute wealth from the State to the council house-buyer". In terms of future rental income foregone, because the level and annual rate of increases of rent were higher in Conservative-controlled than in Labour-controlled authorities, the opportunity costs of encouraging the sale of stock was greater in Conservative authorities encouraging sales than in the Labour authorities prohibiting sales.<sup>53</sup>

Policy towards public and owner-occupied housing was intensively debated in the Treasury at roughly the same time as the Meade Committee was meeting. In the Treasury Ian Byatt was very keen to reintroduce Schedule A, but the Secretary of State for the Environment, Peter Shore, was opposed to the taxation of imputed income. Shore was keen to use the removal of higher rate tax relief as a quid pro quo for reducing subsidies and consequently raising council house rents, so as to appease Treasury calls for an improved rate of return on these capital assets. Although the tax-relief offered to owner-occupiers cost less than subsidies to local authority tenants, for some in the Treasury like Douglas Wass it was seen as having a useful incentive effect. Wass thought that the scrapping of higher-rate mortgage tax relief would remove an important incentive to managers who had no inherited capital.<sup>54</sup> Here again was access to capital viewed as an important incentive for middle management. In fact MIRAS (Mortgage Interest Relief At Source) was gradually withdrawn by the Thatcher governments.

Robert Solow referred to James Meade as the last great utilitarian, and perhaps the Meade Report was one of the last systematic statements of a utilitarian outlook.<sup>55</sup> The sections of the report on the taxation of unearned wealth reflected a view of Meade's like that of Tawney that the redistribution of wealth was at least as important as that of income. Wealth allowed 'access' and for Tawney what was 'repulsive' was not income inequality but that "some classes should be excluded from the heritage of civilization which others enjoy".<sup>56</sup> For Meade too, fundamental to the creation of a more enterprising, dynamic economy and society was the redistribution of wealth, the removal of "unacceptable inequalities of opportunity, wealth and privilege"<sup>57</sup>, and the weakening of concentrations of power.

It was not simply that the government was opposed to the disturbance of fundamental reform, but rather that it fundamentally disagreed with Meade's views on the redistribution of wealth. In correspondence with Margaret Thatcher and Keith Joseph, Howe would refer to Meade as a 'socialist'<sup>58</sup> and while Meade regarded himself as liberal (like Keynes) he did share the concerns of Tawney and would probably not have dissented from Crosland's view in 1956 that "the largest inequalities stem not from the redistribution of earned incomes, but from the ownership of inherited capital".<sup>59</sup>

## Taxation and inequality after the Meade Report

<sup>53</sup> Foreman-Peck, "Appraisal of sales", p. 80.

<sup>54</sup> TNA T364/102, (1977), p. 4, para. 5i.

<sup>55</sup> Solow, "James Meade".

<sup>56</sup> Kymlicka, "Left-Liberalism", p. 13.

Tawney, *Equality*, p. 113.

<sup>57</sup> IFS, *Structure and Reform*, Preface

<sup>58</sup> Meade, *Efficiency*.

<sup>59</sup> Phelps Brown, *Egalitarianism*, p. 343.

Since the publication of the Meade Report there has been steady reshaping of the structure of taxation, notably in the shift from income tax and towards taxes on expenditure, of which Value Added Tax is the prime example. In 1978 36.6% of government current account revenue came from income tax and 9.6% from VAT.<sup>60</sup> By the time of the successor to the Meade Report, the *Tax By Design* (2011) Report of the IFS committee chaired by James Mirrlees, income tax was expected to contribute 28% of government tax receipts and VAT 17.8%. Notably in the 2011-12 tax year, the expected contribution to total tax receipts from the taxation of capital was small: Capital Gains Tax (0.6%); inheritance tax (0.5%); stamp duty on land (1.05) and stamp duty on shares (0.6%). Using data on the annual tax receipts in cash (so not on an accrued basis) and comparing 1978-79 with 2015-16, the share of total receipts from income tax fell from 39% to 31.6%, while receipts from VAT rose from 10.2% to 21.6%. Amongst other sources of revenue, the share from national insurance remained static, as too did revenue from fuel duties. The share of revenue from tobacco duties fell from 5% to 1.8%, and that from corporation tax from 8.1% to 5.3%.<sup>61</sup> Without fanfare, the UK moved towards taxing expenditure, a move which was reinforced by the tax-relief offered for saving (the postponement of expenditure) in the various ISAs and PEPs and occupational pension schemes.<sup>62</sup> As marginal tax rates fell, so the incremental attractions of saving in these tax-free instruments may have declined in theory, but the practical ability to build-up a large tax-free capital sum over a life-time remained attractive.

The main asset held by households remained their home, and as the proportion of the electorate owning their home grew, so too did the taxing of inheritance become more politically sensitive. Changes in the availability of credit and historically low real interest rates contributed to rising property prices, and to asset prices (equities for example) in general. While income inequality fell by some ten percentage points from 1938 to the 1970s and then rose by some ten percentage points between 1977 and 1991, inequality of wealth always remained much greater than that of income.<sup>63</sup> The Gini coefficient for the distribution of wealth was far higher than that for net incomes.<sup>64</sup> Between 1979 and 1989 there was a stabilisation in the share of wealth held by the top 10% of taxpayers.<sup>65</sup> In 1976 the Gini coefficient was 66% and 65% in 1995. However, by 1999 the top 1% had increased their share of marketable net wealth to 23% of the total, from 17% in 1991. To some extent, this rise in the inequality of wealth distribution may have reflected the effects of the earlier increased income inequality, to which were added the effects of the stock market boom in the late 1990s and the rise in house prices.<sup>66</sup> Yes, while inequality of wealth increased in the 1990s, so too did the number of voters who felt vulnerable to inheritance tax. Given the decision not to pursue a Meade-style PAWAT approach to the taxation of inheritance and capital transfers, such liabilities could be lumpy and were a concern to many who did not regard themselves as wealthy, and who were likely to invoke arguments of earned entitlement. The concentration of wealth in housing among those with modest estates alongside rapid house price increases was largely responsible for the increase in the number of IHT payers from 18,000 to

<sup>60</sup> Central Statistical Office, *National Income*, Table 7:1. Income tax receipts include tax credits.

<sup>61</sup> IFS, Fiscal Facts webpage

<sup>62</sup> Hannah, *Inventing Retirement*.

<sup>63</sup> Atkinson and Brandolini, "On Data".

<sup>64</sup> Hills, *Inequality*, p. 30.

<sup>65</sup> Johnson, "Assessment", p. 8.

<sup>66</sup> Hills, *Inequality*, p. 32.

34,000 (from 3% to 6% of deaths) between 1998/99 and 2006/07.<sup>67</sup> While larger estates had larger investments in shares and other assets, many who newly fell into the IHT net were in illiquid homes, in which they remained as the value to them of the home exceeded that to others of the house. Yet while causing resentment to many, IHT raised little revenue. Even following a decade of rising housing wealth, when the proportion of death estates liable for inheritance tax more than doubled in a decade—increasing from 2.3% of the total in 1996–97 to 5.9% in 2006–07 the revenue raised was still small.<sup>68</sup> Inheritance tax was paid on only 3% of estates in 2009/10 and raised less than 0.5 per cent of all tax revenue.<sup>69</sup> This mismatch between the political controversy which they excited and the amount of revenue which they raised did nothing to increase the political appeal of wealth taxes. Even when previously another Kaldor-inspired idea, the Capital Gains Tax, had been introduced in the 1965 Budget, it raised a disappointing level of revenue.<sup>70</sup>

Arguments persist over the use of the tax system to create incentives for work and entrepreneurship, while also addressing the inequality which was of concern to Meade. In his 2015 book *Inequality: What Can Be Done?*, Tony Atkinson pushed again for a more progressive income tax structure and for a revisiting of ideas for greater taxation of wealth.<sup>71</sup> In his 2014 book, *Capital in the Twenty-First Century*, Piketty expressed concern at how ‘when the rate of return on capital exceeds the rate of growth of output and income’, it gives rise to ‘arbitrary and unsustainable inequalities that radically undermine the meritocratic values on which democratic societies are based’.<sup>72</sup> The recent Brexit vote is seen by some as an expression of dissatisfaction by groups who feel that they no longer benefit from economic growth, and that, to reprise Tawney, who feel ‘excluded’ from the benefits enjoyed by others. One of the lessons of Les’s work over the years is that capitalism, for all of its faults, survives by adapting and changing. As it enters another period of disruptive technological change, it will need to find ways to ease grievances about intergenerational inequality, of inequality of opportunity and of exclusion from the benefits of economic growth. One lesson from this study of the Meade Report is that attempts to tax capital will meet strong administrative and political resistance and, if implemented, will not produce the expected level of revenue. In contrast, gradual, quiet change which taxes expenditure is a more acceptable and fruitful approach to taxation, and one which preserves incentives to earn income. Quiet, gradual changes to the expected marginal efficiency of capital were also the main concern of the central chapter eleven of Keynes’s *The General Theory*. Keynes argued for government to address the marginal incentives for fixed capital investment, so as to then raise the level of effective demand in a low-interest rate economy. The most effective change often occurs quietly over time, rather than being achieved through grandiose state projects or announcements. In today’s different circumstances, the designing of incentives to reward entrepreneurship and efficiency remains as central an issue as it was in the 1930s and again in the late 1970-s and 1980s when Les was

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<sup>67</sup> IFS, *Tax By Design*, p. 360.

<sup>68</sup> Adams, Browne and Heady, “Taxation”, p. 22.

<sup>69</sup> IFS, *Tax By Design*, p. 358.

<sup>70</sup> Daunton, *Just Taxes*, p. 290.

Kay and King, *British Tax*, p. 93

Flemming and Little, *Wealth Tax*.

<sup>71</sup> Atkinson, *Inequality*, ch. 7.

<sup>72</sup> Piketty, *Capital*, p. 1.

Chick, “A Few Thoughts”.

spearheading the development of business history with his informed blending of history and economics.

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